

TO: Files

CC: The San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Fredrick Pierce on June 6, 2006

DATED: June 21, 2006

On Tuesday, June 6, 2006, Benito Romano, Sharon Blaskey, and Jesenia Ruiz de la Torre, in Willkie Farr & Gallagher LLP's ("WF&G") capacity as counsel to the Audit Committee, interviewed Fredrick Pierce. Mr. Pierce's counsel, Knut Johnson was also present. The interview took place in a conference room on the 3rd floor of the City Administration Building, 202 C Street in San Diego, and lasted approximately four hours.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Fredrick Pierce, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Mr. Romano began the interview by explaining the circumstances and purpose of the City of San Diego's (the "City") creation of the Audit Committee, noting that information obtained during the course of the interview would be used, if relevant, in the Audit Committee's eventual report. Mr. Romano explained that Willkie does not represent Mr. Pierce and, thus, statements made during the interview are not covered by the attorney-client privilege. Nonetheless, we would be treating the information obtained during the interview as confidential, covered by the work-product privilege during the investigation, but any such privilege would likely be lost with the release of the Audit Committee's report. Mr. Romano asked that Mr. Pierce keep the interview confidential. Mr. Romano further explained that, if requested, we would provide information from the interview to the SEC, the U.S. Attorney's Office or the City's outside auditor, KPMG, so it is important that Mr. Pierce be accurate and truthful. Mr. Romano emphasized that Mr. Pierce should seek clarification of any question at any time.

Mr. Pierce asked how the report that WF&G was issuing was any different than the report issued by V&E. Mr. Romano explained that the V&E report was not conducted independently, because V&E represented the City at the same time that they conducted their investigation. Mr. Romano stated that KPMG was not satisfied with V&E's report and that they would not complete an audit based on it. Mr. Pierce asked if the completion of the report by WF&G, along with KPMG expressing satisfaction regarding the report, would result in KPMG issuing the audit. Mr. Romano replied that that was correct.

Background

Mr. Romano asked Mr. Pierce when he served as the President of the SDCERS Board. Mr. Pierce replied that he served as President from 2000-2005. Mr. Romano asked if Mr. Pierce was appointed by Mayor Susan Golding. Mr. Pierce stated that a member of her staff, with whom he was acquainted through the San Diego State Young Alumni Association, suggested that he be appointed, but that the Mayor made the actual appointment. Mr. Pierce stated that someone who had just left the Board had some real estate background and that he had a similar background.

Mr. Romano asked Mr. Pierce if he received an orientation regarding actuarial principles when he joined the Board. Mr. Pierce stated that while there was not a formal orientation, Lawrence Grissom (SDCERS Administrator) gave Mr. Pierce an overview of the System during a meeting they had over lunch. After that Mr. Pierce learned about the System by attending Board meetings.

Mr. Romano asked Mr. Pierce what SDCERS staff members he interacted with during his tenure on the Board. Mr. Pierce recalled that he spoke to some of the more senior individuals, including Grissom, Lorraine Chapin (SDCERS General Counsel), Doug McCalla (Head Investment Officer), and Paul Barnett (Chief Operating Officer). Those individuals regularly attended meetings and were a resource for Board members.

Mr. Romano asked Mr. Pierce if the Board was organized into committees. Mr. Pierce replied that they were. Mr. Romano asked Mr. Pierce on which committees he served as a member. Mr. Pierce recalled that he was on the Investment Committee and that he was the Chair of the Real Estate Investment Subcommittee. The Investment Committee discussed investments and investment policies. McCalla and Don Clark (Assistant Investment Officer) assisted the Investment Committee, along with other lower level SDCERS staff, to set investment policy and monitor the Fund's investment performance. Annually, the Fund's asset allocation would be considered to understand how much of the assets were invested in stocks, bonds, international investments, and real estate, among other categories. The Investment Committee also monitored investment performance on a quarterly basis. McCalla would provide that information to the Committee. Mr. Romano asked Mr. Pierce if unaudited financial statements were ever provided to the Board. Mr. Pierce recalled that they were. Mr. Romano asked what type of information the statements contained and whether they included information regarding SDCERS investments. Mr. Pierce recalled that the statement the Board received was a two page balance sheet, but that it did not contain any information regarding investment performance. Investment performance was discussed in the quarterly reports. When he became President, Mr. Pierce was on all of the committees, *ex-officio*, but he only attended meetings of the Audit Committee and the Investment Committee. Mr. Pierce rarely attended meetings of the Business and Procedures Committee. Mr. Romano asked Mr. Pierce what issues the Business and Procedures Committee handled. Mr. Pierce recalled that they essentially covered any business of the Board that was not covered by the Audit Committee or the Investment Committee, including setting agendas for meetings and considering actuarial information. Mr. Romano asked if the Business and Procedures Committee met on a monthly basis. Mr. Pierce replied that they did. Mr. Romano asked Mr. Pierce how often Committee meetings were held. Mr. Pierce stated that while he was on the Board, typically Committee meeting would be held once a month on either Thursday or Friday. Mr. Romano asked Mr. Pierce if Board members were ever consulted

informally, outside of meetings. Mr. Pierce stated that he was not and that he would not even talk to the administrator on a regular basis. Nevertheless, when the System came under scrutiny by the press and litigation was ongoing his interface with the retirement administrator became quite regular. Mr. Pierce would meet with the administrator because he was the Board's spokesperson and he needed to be kept informed. Mr. Romano asked Mr. Pierce if he had any contact with City officials as the President of the Board. Mr. Pierce replied that he did not.

Mr. Romano asked how frequently the Business and Procedures Committee received actuarial reports. Mr. Pierce stated that one would be issued annually. The report would be presented to the Board in draft form and then after a few months passed, during which the Board and the Business and Procedures Committee would "digest" the report, the final version would be presented. Mr. Romano asked if it was common to have an actuarial report for the previous fiscal year issued in February. Mr. Pierce said it was. Mr. Romano asked if after the close of the fiscal year, on June 30th, the actuary started working towards completing the report. Mr. Pierce replied that he did not know if that was the case. Mr. Romano asked Mr. Pierce when the Board would first receive a draft of the report. Mr. Pierce replied that he did not know exactly, but he assumed that the draft would be given to the Board as soon as it was available. Mr. Pierce recalled receiving the draft report in a Board packet and that draft would then become public after the meeting at which it was discussed. Mr. Pierce stated that there was not "a lot of difference between the draft and the final" report. After the report was reviewed by the Board, the actuary would communicate that there were ranges for the assumptions that would be deemed professionally responsible. The Board would choose an assumption within the ranges proposed by the actuary. Mr. Romano asked Mr. Pierce if he could recall any particular changes to the assumptions that the actuary had proposed. Mr. Pierce stated that he could not and then mentioned that making actuarial assumptions "was almost an art." Mr. Romano asked Mr. Pierce if any committee interacted with the actuary or if the actuary provided any services to the Board throughout the year. Mr. Pierce stated that normally the actuary was only involved with the report at the end of the year, but that when the Board was involved with litigation starting in 2002, actuarial analysis was required throughout the year to understand the impact of the stock market and MP-2.

Mr. Romano asked Mr. Pierce if he participated in evaluating employees. Mr. Pierce stated that he formalized a system used to evaluate the administrator. An Administrator Review committee was established that would evaluate the administrator every year, but when Committee members were very busy, evaluations did not occur that often. To conduct an evaluation, evaluation forms would be sent to the staff and to trustees. The results were maintained confidential and would be entered into a matrix to tally the scores from the evaluation sheet. The administrator's salary would be based on his evaluations. Mr. Romano asked if, as a result of the evaluations, salaries increased or decreased. Mr. Pierce recalled that they increased. Mr. Romano asked if the administrator was evaluated using the same criteria each year or if new goals were established on a yearly basis. Mr. Pierce recalled that generally, questionnaires remained the same year after year, but that there were additional goals that were set each year. The Board would set certain yearly goals and if those were met, then the administrator would be entitled to a raise. Mr. Romano asked what types of goals were set and whether they were related to the funding ratio. Mr. Pierce recalled that one goal was to establish a website for the System and that the goals did not relate to the funding ratio, because that was

out of the control of the administrator. The goals were focused on issues that were within the control of the administrator.

Mr. Romano asked Mr. Pierce if he was involved in the *Gleason* settlement. Mr. Pierce stated that he was involved in approving the settlement as a Board member. Mr. Pierce felt that suing individuals Board members in that litigation was "a scare tactic."

The Blue Ribbon Committee's Report

Mr. Romano asked Mr. Pierce if SDCERS staff gave the Blue Ribbon Committee ("BRC") information regarding the pension system. Mr. Pierce stated that he was not involved with that process, but he assumed that the staff provided the BRC with information.

Mr. Romano asked Mr. Pierce if he had formed an opinion regarding the BRC's recommendations. Mr. Pierce recalled that prior to the report coming out and prior to the drop in the market, the System was fully funded and the problems with the funding ratio were not on anybody's radar. In addition to being fully funded, the City's contributions under MP-1 were increasing by 0.5% of payroll annually.

Mr. Romano asked Mr. Pierce how SDCERS determined what the scope of its response would be to the BRC's report. Mr. Pierce recalled that there were two issues that needed to be addressed. The first was regarding quantifying retiree healthcare liabilities, but that was not an issue that was considered by SDCERS, because it was not a defined benefit. The second issue involved the current funding status of the System and projections of the funding ratio. Mr. Pierce decided that a Committee needed to be formed to address the BRC's report. Richard Vortmann (SDCERS Board member), Ray Garnica (SDCERS Board member), and Mr. Pierce were on the committee that explored the issues addressed in the BRC's report. Mr. Romano asked how it was that the BRC decided to respond to issues within the pension system by presenting a broad analysis which made projections of the City contributions into the future, since that the BRC's report simply made a recommendation regarding the City's contributions into the fund. Mr. Pierce replied that the BRC was looking at a snapshot when it conducted its analysis, but that the funding ratio was plummeting as a result of losses in the stock market. Mr. Romano asked if, as a result of that perspective, it would be more appropriate for SDCERS to have a response that considered long-term projections of the funding ratio. Mr. Pierce recalled that "most people," such as City employees on the Board, wanted to see long-term projections. When the Committee involved the actuary, the scope of the response became forward looking. Mr. Romano asked if debates occurred regarding the scope of the response by SDCERS, especially considering that additional time was required in order for SDCERS to provide a long-term response. Mr. Pierce stated that after consulting with the actuary it was apparent that long-term projections were needed to provide a comprehensive and responsible response. Mr. Pierce could not recall whether Richard Roeder (SDCERS actuary) or Grissom made that decision (he could not recall the specifics of why the final decision was made). Mr. Pierce reviewed the BRC's report (Exhibit 1) and Mr. Romano asked Mr. Pierce if the recommendations regarding the pension system refreshed his recollection regarding how the scope of the response by SDCERS was shaped. Mr. Pierce stated that he still could not recall how the response by SDCERS developed into a long-term approach. Mr. Pierce stated that there was a concern regarding the City's contributions increasing over time. Mr. Pierce recalled that Terri Webster wanted long-term projections to be done and that she wanted to have the actuary come before the

Board with recommendations so that the City could adjust its budget accordingly. Mr. Romano asked if it was the norm for the Board to be involved in City budget issues. Mr. Pierce stated that the administrator listened to a variety of issues that related to SDCERS, including budgetary issues and how they impacted SDCERS.

The Decline of the Funding Ratio

Mr. Pierce reviewed the SDCERS Annual Actuarial Valuation for the fiscal year ending on June 30, 2001 (Exhibit 2). Mr. Romano noted that the valuation was released in February 2002, the same time that the BRC issued its report. Mr. Romano noted that the funding ratio had fallen to 90%. Mr. Pierce stated that that number was "comfortable."

Mr. Romano asked Mr. Pierce to review the memo SDCERS wrote in response to the BRC's report (Exhibit 3) and noted that the response stated that the funding ratio declined largely as a result of investment losses. Mr. Romano asked Mr. Pierce if he thought that was accurate in hindsight. Mr. Pierce stated that he thought that it was.

Mr. Romano asked Mr. Pierce if he had read the Pension Reform Committee's ("PRC") report and asked Mr. Pierce to review that document (Exhibit 4). Mr. Romano directed Mr. Pierce's attention to the section that indicated that the decline of the funding ratio was due to investment performance (6%), underfunding by the City (10%), the use of plan earnings to pay for contingent benefits (12%), net actuarial losses (31%), and increased benefits (41%). Mr. Romano asked Mr. Pierce if he thought that breakdown was accurate. Mr. Pierce replied that it "was all wrong." Mr. Pierce stated that the System was fully funded until 2000, so conducting an analysis using a timeframe starting five years prior to that date was improper. Prior to 2002, the Board was told by the actuary that the System's funding ratio was 90-93%, so no one was aware of a funding problem. Mr. Pierce stated that the PRC was inferring that everyone should have had a crystal ball and they were trying to "cast blame" on what was responsible for the decline of the funding ratio. Mr. Romano explained that that was why he had asked if he still felt that investment losses were the cause of the underfunding in hindsight. Mr. Pierce stated that he could not recall Roeder giving the Board the information contained in the PRC's report. Mr. Pierce stated that Roeder said that 15% of the losses could be attributed to sources other than investment losses. Mr. Pierce thought that the PRC's conclusions regarding the causes of the decline of the funding ratio were misleading. Mr. Pierce stated that the Board needed to take the best information that was available to them at the time to consider what would occur in the long-term. Mr. Pierce felt strongly that the only event that impacted the funding ratio, aside from *Corbett*, from 2000-2003 was investment losses.

Mr. Romano stated that in his SEC testimony, Mr. Pierce said that a factor that affected the decline of the funding ratio was the waterfall's, stripping away assets to pay contingent benefits considering the decline of the ratio starting in 2000. Mr. Pierce stated that as part of the actuarial report, the actuary considered what created losses. Mr. Pierce concluded that 85% of the System's losses were attributable to investment losses based on the actuarial report.

Mr. Pierce reviewed a letter from Connie Hiatt (SDCERS outside counsel) to Chapin, dated April 16, 2002 (Exhibit 5). The letter described the components of the waterfall. Mr. Pierce recalled working with Hiatt and Chapin to understand the appropriate use of the waterfall because it was not "crystal clear." He thinks he may have seen the letter. He was not a

"fan" of the waterfall, but it was required according to the Municipal Code. When the funding ratio declined, Mr. Pierce started considering the elements that were contributing to its decline, and the waterfall was a factor. Mr. Pierce thought that the City needed to decide to grant or deny benefits rather than making them contingent and paying for those benefits out of surplus earnings. Mr. Pierce recalled that the use of the waterfall impacted the funding ratio by 25 basis points.

Mr. Pierce reviewed an e-mail from Terri Webster (Assistant Auditor and SDCERS Board member), dated October 9, 2001 which stated that "YTD CERS earnings as of August 31, 2001 in the CERS Trust fund is about \$15 million compared to \$53 same time 2000...a 71% drop!" (Exhibit 6) and a December 3, 2001 e-mail stating that the year to date earnings had dropped 87% (Exhibit 7), which described the decline of SDCERS investment earnings. Mr. Romano asked Mr. Pierce what he thought Webster was evaluating when she made the statements contained in the e-mails. Mr. Pierce thought that since she was the auditor, she may have obtained that information while looking at monthly bank statements or settled transactions. Mr. Romano asked Mr. Pierce if he recalled being told that the October statements showed a loss of \$15.4 million, as the December 3, 2001 e-mail indicated (Exhibit 7). Mr. Pierce stated that that was not brought to his attention. Mr. Romano asked if that was information he would have expected to be brought before the Board. Mr. Pierce stated that it was not, because she was just looking at bank statements or reconciliation statements. Additionally, the Board would not have been monitoring investments this early on in the year. Mr. Romano asked Mr. Pierce why he thought Webster was interested in this information early in the fiscal year. Mr. Pierce guessed that she may have wanted to know because the City would need to make payments under the waterfall if earnings continued to decline and there were insufficient surplus earnings to cover them. Mr. Romano asked Mr. Pierce if he would have expected Grissom to come to the Board with this information. Mr. Pierce stated that if the quarterly report was negative, that information was brought before the Board.

Mr. Pierce reviewed a letter from Robert Klausner (SDCERS counsel) to Grissom, dated June 10, 1998 (Exhibit 8). Mr. Pierce could not recall who Klausner was and could not recall seeing the letter.

MP-2

Mr. Romano asked Mr. Pierce when he first recalled learning about the possibility of the trigger under MP-1 being hit. Mr. Pierce replied that he could not recall the date for sure, but he thought it was in late 2001 or early 2002. Mr. Romano asked Mr. Pierce if he associated the trigger with the work of the BRC. Mr. Pierce said that he did not necessarily make that association. Vortmann was on the BRC and he raised issues regarding the pension system before the BRC was convened, which was why he was put on that Committee. Ms. Blaskey asked if Vortmann was a member of the BRC at the same time that he was a member of SDCERS Board. Mr. Pierce replied that he was.

Mr. Romano asked Mr. Pierce when he became aware that the City was contemplating increasing benefits in 2002. Mr. Pierce stated that he was not sure, but that he did not pay very much attention to that process.

Mr. Pierce reviewed what appeared to be an outline of the presentation given by City Manager Michael Uberuaga to the Board on May 29, 2002 (Exhibit 9). Mr. Romano asked Mr. Pierce if he recognized the document. He replied that he did not. Mr. Romano asked Mr. Pierce if he recalled Uberuaga making a presentation to the Board on that date. Mr. Pierce replied that he did. Mr. Romano asked Mr. Pierce if Uberuaga handed anything out at that meeting. Mr. Pierce could not recall, but stated that it looked like the Exhibit may have been a list of Uberuaga's talking points. Mr. Romano asked if Mr. Pierce or Grissom had any conversations with Uberuaga on this topic prior to the May meeting. Mr. Pierce stated that he did not have any, but he assumed that Grissom would have in order to put the item on the docket. Mr. Pierce could not recall being provided with any information regarding the proposal prior to the meeting. Mr. Romano asked if the proposal by Uberuaga included reducing the trigger to 75%. Mr. Pierce said that it did.

Mr. Romano asked Mr. Pierce if he discussed the proposal with anyone between the May and the June SDCERS Board meetings. Mr. Pierce stated that he spoke with Bruce Herring (Deputy City Manager) at Herring's office. According to his calendar, Cathy Lexin (SDCERS Board member) and Grissom were also present. Mr. Pierce wanted to have that meeting to express his view that the proposal was "wholly unacceptable" and that any suggestions of linking benefits to the proposal were unacceptable. Mr. Pierce thought that the proposal needed to "get the heck out of my board room" unless it would improve the System's position compared to MP-1. Mr. Romano stated that it looked like Mr. Pierce was angry about the proposal. Mr. Pierce stated that he wanted to send a message. Mr. Romano asked if Mr. Pierce wanted to send a message because the linkage of the benefits was inappropriate. Mr. Pierce responded that that was the case. Mr. Romano asked what made him think that the benefits were linked. Mr. Pierce recalled that Uberuaga said they were linked during his presentation. Mr. Pierce stated that he asked that the City's contributions be doubled so that the full funding ratio could be reached more quickly. Herring's response was that the City Council "would not go for that." Mr. Pierce thought that how the City Council felt was unimportant, because it was his job to ensure that any restructuring of MP-1 resulted in a benefit to SDCERS.

Mr. Romano asked Mr. Pierce what advice he received from the actuary in connection with MP-2. Mr. Pierce stated that he could not recall specifically, but that Roeder clearly thought that the trigger was in jeopardy of being hit that year. The funding ratio was 89% for the fiscal year ending in June 2002, and it was predicted that the market would continue to decline. Mr. Romano asked if this decline was expressed in the quarterly reports. Mr. Pierce stated that it was. Mr. Romano asked Mr. Pierce if there was any sense of what the funding ratio was in June. Mr. Pierce recalled that the common expectation was that the trigger might be hit by approximately 1%. This information was conveyed by Roeder and possibly Grissom as well. Mr. Romano asked whether, in conversations with Herring, it appeared that he thought the trigger was close to being hit. Mr. Pierce replied that there was no question that the City was concerned with the potential for the trigger being hit and being required to make a balloon payment. Mr. Romano asked Mr. Pierce what he thought would occur if the trigger was hit. Mr. Pierce recalled thinking that contributions would need to be made sufficient to bring the ratio to 82.3%. Another interpretation was that contributions needed to be made to fully fund the System. Mr. Pierce felt as though SDCERS was a lender and the previous officers had made a loan which needed to be restructured. The Board was considering whether MP-1 or a new proposal would be more beneficial to SDCERS.

Mr. Pierce reviewed a letter Roeder sent to Grissom, dated November 7, 2002 (Exhibit 10). Mr. Romano asked what prompted this letter. Mr. Pierce stated that the Board expected an opinion from the actuary and fiduciary counsel regarding MP-2. Mr. Romano asked Mr. Pierce if he felt the letter was a strong endorsement of MP-2. Mr. Pierce said that the letter seemed to be "his [Roeder's] take on what was going to transpire." Mr. Romano stated that the letter seemed to say that since it was likely that the trigger would be hit, the System would receive higher contributions under MP-1. Mr. Pierce stated that MP-1 increased contributions over time. Mr. Romano asked Mr. Pierce if he recalled Roeder stating that MP-2 was problematic because it involved benefits. Mr. Pierce did not recall that being said. Mr. Romano asked Mr. Pierce if he recalled being disappointed in Roeder's reaction to the proposal. Mr. Pierce stated that was not the case. Mr. Pierce said he wanted Roeder to give his honest opinion so that he could consider that in making a decision. Mr. Pierce thought that if the trigger was hit, the funding ratio would probably only fall just below it. Roeder said that he did not know if the trigger would be hit that year, but that it probably would in the next valuation. Roeder had not completed his valuation when the proposal was approved, he completed it in the following February. It was at that time that it was clear that the trigger had been hit. Mr. Romano asked when the earliest time that Roeder gave a valuation in the past was. Mr. Pierce recalled that he once received a completed valuation in December. Mr. Romano asked Mr. Pierce if he knew anything about the process Roeder engaged in to complete his analysis. Mr. Pierce stated that he did not. Mr. Romano asked Mr. Pierce if he thought Roeder was competent and honest. Mr. Pierce replied that he did.

Mr. Pierce reviewed a presentation made by Bob Blum (fiduciary counsel) and Hiatt (Exhibit 11). Mr. Romano asked Mr. Pierce if he recalled this presentation being made. Mr. Pierce stated that this was probably a slide show they had prepared. Mr. Romano noted that the presentation contained a number of tasks that needed to be done in order for the Board to comply with their fiduciary responsibilities. Mr. Romano asked if all of those steps had been undertaken. Mr. Pierce stated that all of the work had been done by Roeder and Blum. They spent a lot of time considering MP-2 and developing projections. Hiatt and Blum actually negotiated the deal. On July 11, 2002, many of the terms of the agreement were approved by the Board, but Mr. Pierce recalled that a lot of additional work needed to be done regarding the proposal, for example the nullification provision (which was critical to the Board's approval) had not yet been agreed to. Additionally, the business terms were subject to the approval of counsel and the actuary. Mr. Romano asked Mr. Pierce why the nullification provision (which allowed the Board to void the agreement) was critical to the Board. Mr. Pierce stated that the Board was not concerned about being sued, but that provision gave the Board "comfort." Mr. Pierce wanted to include the nullification provision so that if market changes rendered MP-2 unsound, as was the case with MP-1, then the Board could invalidate the agreement. Mr. Romano asked if Blum had suggested the nullification provision because the law could potentially change. Mr. Pierce could not recall that as the basis for the recommendation, and his recollection was that Blum "drew the line in the sand" saying that the Board needed that "rip cord" because they did not know what circumstances could arise. Mr. Romano asked if requiring the nullification provision reflected a lack of confidence of by the Board in the proposal. Mr. Pierce stated that no one ever brought that up. Mr. Pierce stated that if the funding ratio dropped below the trigger by 1% that would only require the City to contribute approximately \$25 million. He said that compared to the overall value of the System, that was not a significant sum compared to the possibility that under MP-2 the System could reach a full funding ratio sooner.

Mr. Romano asked Mr. Pierce what Roeder's position was regarding the proposal on July 11th, prior to Saathoff's motion. Mr. Pierce said that he would need to review the minutes. Mr. Romano asked if Roeder's opinion had changed after Saathoff made his motion. Mr. Pierce stated that he thought it had. Roeder did not think that the trigger should be reduced without increasing the City's contributions. Then, although Roeder thought SDCERS could obtain a more favorable agreement, Roeder felt that "he could live with the proposal actuarially" after Saathoff's motion. Ultimately Roeder said he could support the proposal, but he would have supported a "stronger" proposal to a greater extent. Roeder stated that the System was not in "actuarial nirvana," but that the System was "okay."

Mr. Romano stated that the minutes of the July 11, 2002 SDCERS Board meeting seemed to indicate that Herring stated that if the Board did not take action, then management would need to consider whether the increased benefits would be implemented. Mr. Romano asked Mr. Pierce if he felt that put the Board in an awkward position. Mr. Pierce stated that throughout that Board meeting he tried to let the Board know that it had "no business with benefits and that [the Board was] only considering a contribution agreement." Mr. Pierce was confident that he had let the Board know that they only needed to consider the modification to the City's contributions. Mr. Pierce recalled John Torres asking if the increased benefits would be lost if the Board did not approve the proposal. Mr. Herring stated that he did not know. Mr. Romano asked if based on Herring's statements at the meeting, Mr. Pierce felt that the benefits were unlinked. Mr. Pierce stated that Herring made it clear that the Board would make their decision independently and then the City would decide whether to grant the increased benefits. Mr. Romano asked if Saathoff's motion resulted in the benefits being decoupled. Mr. Pierce stated that that was the case. Mr. Romano asked if Saathoff's motion was "spur of the moment." Mr. Pierce replied that there was a general sense that the Board was not satisfied with the proposal. Mr. Pierce stated that he had thought that Saathoff might suggest a modification, but he did not know whether Saathoff discussed his proposal beforehand with City officials. Mr. Johnson advised Mr. Pierce not to answer additional questions regarding this topic because it was discussed during the grand jury investigation. Mr. Romano stated that documents suggest that the City knew about Saathoff's proposal and that it was acceptable to the City. Mr. Romano asked if that information would have undercut his thinking that, through Saathoff's motion, the benefits had been decoupled. Mr. Pierce replied that efforts to decouple the benefits began when the proposal was initially brought before the Board. Mr. Romano asked Mr. Pierce if he knew that Saathoff had a dialogue with the City. Mr. Pierce stated that he had not known that. Mr. Pierce recalled that Saathoff "loved to stick it to the City," and so he was not surprised when Saathoff used his "brilliance to get the best proposal for System." Mr. Pierce said Saathoff was a tenacious advocate.

Mr. Romano asked Mr. Pierce if he was familiar with the Presidential Leave benefit at the time MP-2 was approved. Mr. Pierce stated that he was not. Mr. Romano asked Mr. Pierce whether he knew that Saathoff purchased service credits. Mr. Pierce stated that he believed Saathoff participated in that program. Mr. Romano asked if Mr. Pierce was aware of that when MP-2 was approved. Mr. Pierce stated that the purchase of service credit issue came before the Board because it was learned that Saathoff never received his copy of the contract and as a result it was decided that he should be entitled to the cost of the program as of the time that he signed the contract. Mr. Romano asked Mr. Pierce if he was aware of any compensation arrangements between Saathoff and the City. Mr. Pierce stated that he did not know of any. Mr.

Romano asked Mr. Pierce if he knew of an arrangement where the City paid for 60% of Saathoff's contributions and his union paid 40%. Mr. Pierce stated that he thought all unions worked in that fashion. Mr. Romano asked Mr. Pierce if he recalled learning generally that service credits were under-priced. Mr. Pierce recalled leaning about that, but he could not recall when. Mr. Pierce recalled that the actuary produced a report which showed that the actual cost, based on age and the number of people involved in the program, resulted in the rates charged not covering costs. This issue was frequently discussed for many months at Board meetings.

Mr. Romano asked how it was that the System was financing the cost of healthcare benefits through surplus earnings. Mr. Pierce stated that he was not aware of the details of that since the measure was initiated prior to his joining the Board. Mr. Romano asked Mr. Pierce what "pay-as-you-go" meant. Mr. Pierce stated that it meant that if there were sufficient earnings to cover all of the items in a prioritized list, then the System would need to pay the cost of healthcare. If there were not sufficient earnings, then the City would bear the cost. Roeder referred to this as "shaving off the mountain top."

Mr. Romano asked if anyone recused themselves because they would receive increased benefits under MP-2. Mr. Pierce stated that he did not recall anyone, including Chapin, recusing themselves. Mr. Romano asked if there was a procedure to abrogate California Government Code Section 1090. Mr. Pierce stated that a motion was passed in order to require public disclosure of the status of the Board members who were also City employees. Mr. Romano asked if that motion was made at a public hearing. Mr. Pierce recalled that it was. Mr. Romano asked Mr. Pierce if he had ever referred to that motion as "a secret." Mr. Pierce stated that he had not. Mr. Romano asked Mr. Pierce who had authored the motion. Mr. Pierce stated that he could not answer that question on the grounds of the attorney-client privilege.

Mr. Pierce reviewed an e-mail he sent to Grissom, dated December 17, 2002 (Exhibit 12). In the e-mail, Mr. Pierce wrote that there was "no WAY" that the System would be forced to "share the pain" with the City. Mr. Romano asked Mr. Pierce what he was referring to when he wrote that the System should not have to "share the pain." Mr. Pierce stated that the e-mail was pretty clear. When issues arose that ate into the City's budget, the City immediately reacted. Mr. Pierce's point was that SDCERS was totally independent from the City and just because there was an issue this year did not mean that SDCERS needed to alter the City's contributions without thinking of the long-term costs involved. The Board needed to think long-term and not budge on the City's pressures to conform to their one year budget.

Mr. Romano asked if the Board ultimately sued and settled a lawsuit against Blum regarding the advice he rendered in connection with MP-2. Mr. Pierce stated that the Board members were sued in *Gleason* and shortly after that the claim for malpractice against Blum settled. Mr. Romano asked if the advice regarding the Board's fiduciary duties that was obtained from Seltzer Caplan changed his view as to whether MP-2 was appropriate. Mr. Pierce stepped out of the room to consult with his counsel. Upon reentering, Mr. Pierce declined to answer any additional questions on this topic on the advice of counsel, out of concerns for protecting the attorney-client privilege.

Mr. Pierce reviewed an e-mail from Sheila Jacobs to Roxanne Parks, dated October 10, 2003 (Exhibit 13). The e-mail stated that Pierce did not want to follow legal advice. Mr. Romano asked what the e-mail was referring to. Mr. Pierce stated that he could not recall

specifically, but that it may have been regarding giving notice of a meeting under the Brown Act. Mr. Romano asked Mr. Pierce if he could recall the advice he was given. Mr. Pierce recalled how the Executive Committee was informal, but that perhaps notice of those meetings was still required. Mr. Pierce explained that if an attorney had told him that notice was required, he would have acted on that advice.

Mr. Pierce reviewed a document containing a series of questions and answers about the pension system, dated June 21, 2002 (Exhibit 14). Mr. Romano asked Mr. Pierce if he recalled this being handed out at a meeting. Mr. Pierce stated that he did not.

Ballpark Bonds

Mr. Pierce reviewed an e-mail he received from Grissom, dated February 19, 2002 (Exhibit 15). In the e-mail, Grissom stated that there was no doubt that Mr. Pierce had seen that Merrill Lynch had purchased the bonds for the Ballpark and asked if "we need to do anything? I think the adage about sleeping dogs has merit." Mr. Romano asked what the reference to something being done meant. Mr. Pierce recalled that the City asked SDCERS to purchase the ballpark bonds as part of the System's investment portfolio. Mr. Romano asked Mr. Pierce if SDCERS had ever been asked to do that on a previous occasion. Mr. Pierce replied that in addition to being approached regarding the ballpark offering, the City asked SDCERS to invest in a hotel that was adjacent to the ballpark. SDCERS declined that offer. Mr. Romano asked Mr. Pierce who approached the Board with those investment opportunities. Mr. Pierce recalled that Herring did so. Mr. Romano asked what the reference to letting sleeping dogs lie meant. Mr. Pierce stated that when the proposal was made, the System did not think that it was a prudent investment and there were prohibitions regarding the types of investments that could be made. With the ballpark bonds, the interest rates were very high and it was a risky investment. That would have presented investors with a good opportunity, but that was not permitted according to SDCERS' investment guidelines. Mr. Romano asked what was meant by the statement that the "saga is behind us." Mr. Pierce stated that it referred to discussions with Herring and how there was a sense of relief because SDCERS no longer had to formally decline the investment opportunity, because Merrill had purchased the bonds.

Disclosure

Mr. Romano asked Mr. Pierce if he generally reviewed the SDCERS CAFR. Mr. Pierce stated that he reviewed the letter he wrote which was included in the CAFR and some financial highlights referenced in his letter. Mr. Romano asked if a committee reviewed the CAFR. Mr. Pierce recalled the review being the responsibility of the SDCERS staff. Mr. Romano asked Mr. Pierce if he was ever asked to review bond offerings. Mr. Pierce replied that he was not.

Mr. Pierce reviewed an e-mail from Grissom to Dawne Clark, dated January 16, 2003 (Exhibit 16). In a letter attached to the e-mail, Vortmann stated that a disclosure in the CAFR was misleading. Mr. Romano asked if Mr. Pierce was involved with Grissom in responding to that allegation. Mr. Pierce recalled asking Grissom both to respond to Vortmann, and to investigate to determine whether Vortmann was accurate. Mr. Pierce recalled thinking that Vortmann was learning a great deal as a new Board member and he occasionally misinterpreted information or thought that something was an issue, when that was not the case.

Mr. Pierce stated that Vortmann was educating himself and that he was one of the best members of the Board. Vortmann was productive and acted in the System's best interests.

Mr. Pierce reviewed a memo from McCalla to Grissom, dated January 27, 2003 (Exhibit 17). Mr. Romano asked Mr. Pierce if he had reviewed that memo. Mr. Pierce suspected that he had, but he could not specifically recall. Mr. Romano asked if he had discussed the memo with either Grissom or Vortmann. Mr. Pierce could not recall. Mr. Romano asked if Vortmann was satisfied with the response. Mr. Pierce assumed that he was because Vortmann would have followed up if he had any additional questions.

Remediation

Mr. Romano asked Mr. Pierce if he had any suggestions to improve the pension system. Mr. Pierce stated that plan sponsors should not implement agreements where they are not required to pay actuarial rates. The historical practice of paying contingent benefits out of surplus earnings is not a sound concept. The City should decide if a benefit should be granted and then whether to make it a vested benefit or nothing at all. Mr. Pierce stated that the System was now underfunded, but that the problem was manageable. SDCERS's funding status was not disproportional to other systems'.

Mr. Romano asked Mr. Pierce what he thought the proper time horizon should be for amortization, assets, liabilities, and investments. Mr. Pierce replied that when you deal with an unfunded liability caused by investment performance, or with actuarial assumptions which change and evolve, that amortization period should be very long because those are "more all over the place." Benefits that are granted should be considered with short term amortization periods.

Conclusion

At the conclusion of the interview, Mr. Romano and Ms. Blaskey thanked Mr. Pierce for his cooperation, asked that he keep the interview confidential, and requested that Mr. Pierce contact us if he recalled any new information.

WF&G